DOW THEORY LETTERS INC.

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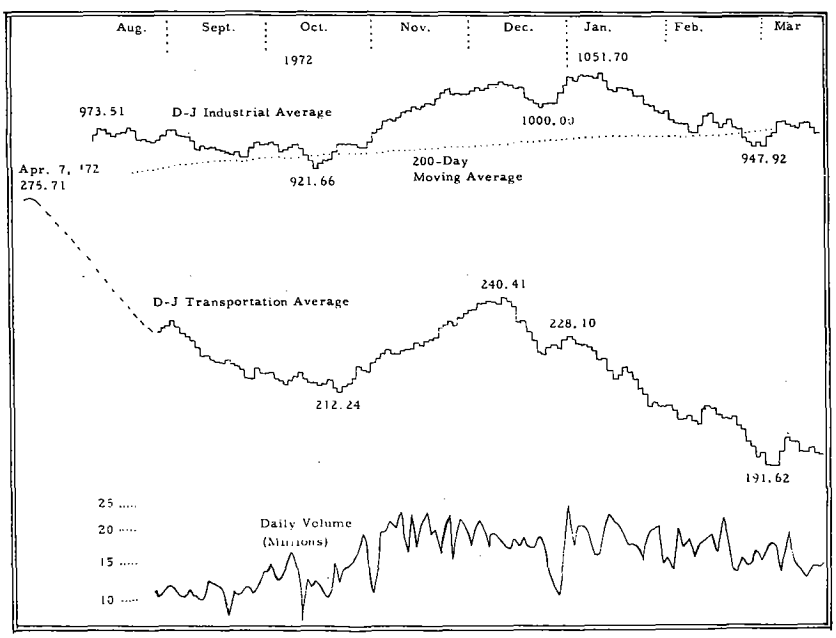
Mar. 9, DJIA 972.23, PTI 909, A-D ratio -7.13
Mar. 16, DJIA 963.05, PTI 896, A-D ratio -7.68

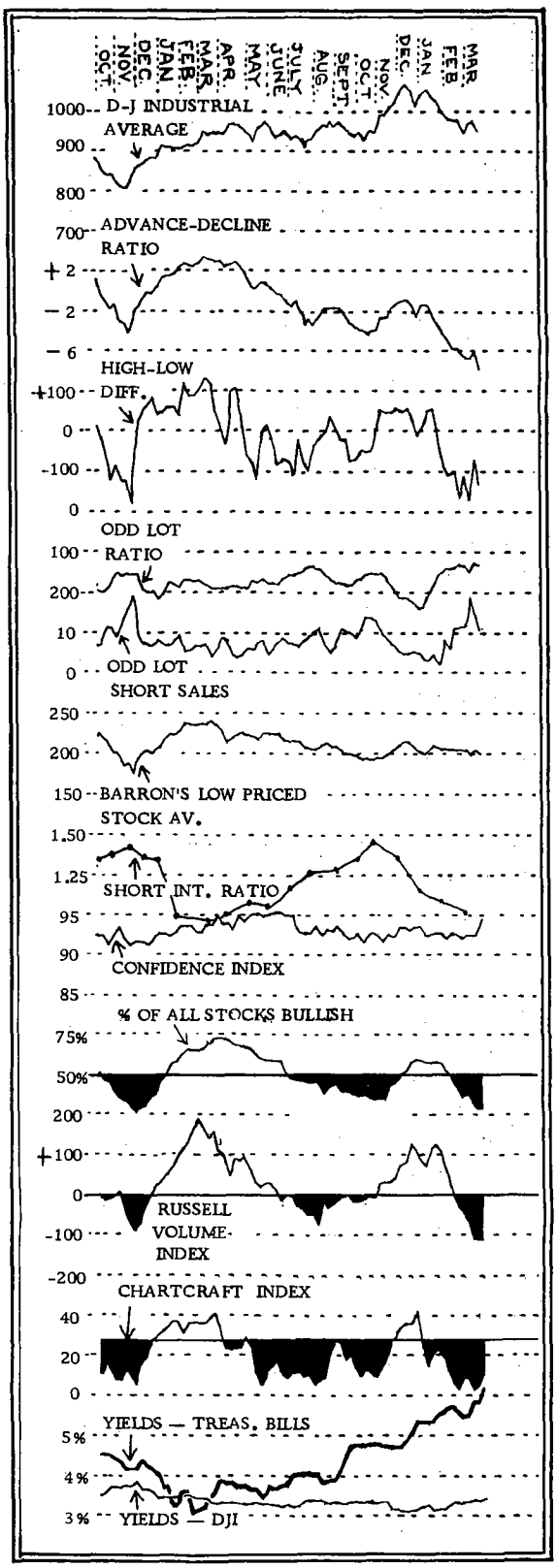
CHOICES: Choice 1, world currencies float against the dollar, the US continues on its current (inflationary) path. Result, continued collapse of the dollar, another monetary crisis within weeks or months, international trade chaos. Choice 2, the US defends the dollar, boosts interest rates, cuts back on spending, the boom topples, stocks cave in, the Dow heads for its 1970 (631.15) bear market lows. The question: Is the President still "a Keynesian?"

THE MARKET: The Primary Trend Index (PTI) is made up of four leading Averages (the Dow Industrial, Transport and Utility Averages), the S & P 500 Average, the advance-decline ratio, the high-low differential, the 15 most-active stocks and the D-J 40-Bond Average. The PTI is computed daily. I consider the PTI to be a very valuable gauge of the technical strength or weakness of the market.

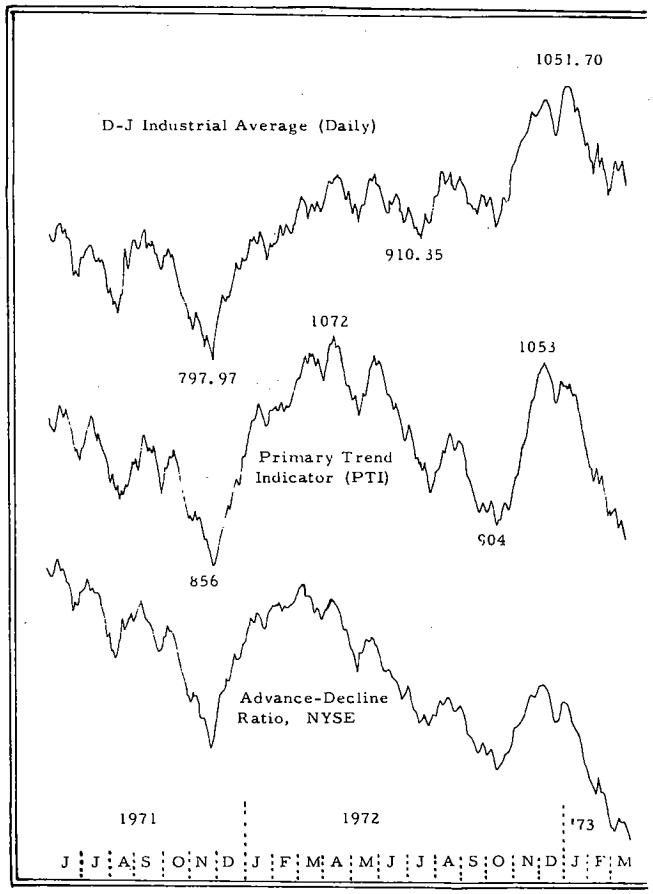
On March 12 the PTI fell to 902, thus breaking below its October 16, 1972, low (see chart on page 2). In doing so, the PTI fell to its lowest level since November, 1971, (at which time the Dow was at 797.97. I consider the March 12 break in the PTI to be ominous, since this penetration implies that the market's technical structure is weaker now than at any time in over a year (despite being extremely oversold). Furthermore, the collapse in the PTI indicates that the weakness has "breadth," that it has spread throughout all sectors of the market.

It should be remembered that the PTI does not simply measure a few averages, it takes into account accumulation and distribution (most-active stocks), interest rates (the Bond and Utility Averages), the blue-chip stocks (DJIA), speculation (Transport Average), the breadth of the market (S & P 500 Average, A-D ratio and the High-lows). Thus, a major penetration by the PTI is something to treat with utmost respect!





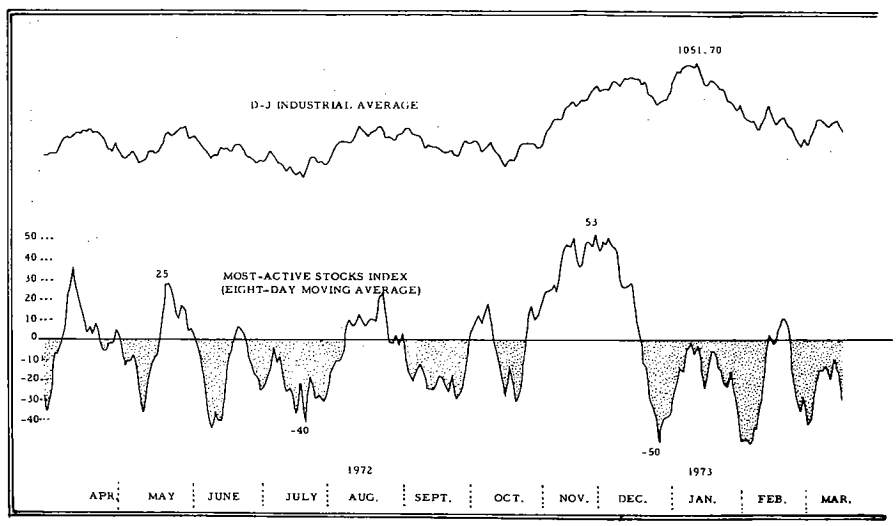
A second study also provides a hint as to the underlying "character" of this market. This is the Most-Active Stock Index (MASI). The Index is computed as follows: Each day I compute the plurality of advances in the most-actives over declines (or vice versa if more declined than advanced), and these pluralities are arranged in the form of an 8-day moving average. They are then plotted with the Dow as shown on this page.



The most-actives make up anywhere from 15% to 30% of daily volume, and the direction of this "most-active volume" often points the way for the next move in the market. Referring to the chart, note that since early-1972 most of the activity in MASI has been on the downside (shaded areas). From mid-October to mid-December MASI did climb to a peak of 53, but in December MASI again dropped into negative territory. With the exception of three plus days in February, MASI has been on the minus side ever since.

So far, during 1973 the performance of MASI has been outstandingly poor with even the sporadic rallies failing to push the Index into a bullish profile. If I read this chart correctly, the late-1972 bulge in MASI shows short-term accumulation based on the impending Vietnam truce. The accumulation ended by early December, and when the actual news of the truce was announced the traders fed out their trading shares. So far, nothing in the profile of MASI gives evidence of new accumulation.

NEAR-TERM: As stated in the last report, the market has remained heavily "oversold" since the first week in February. When this occurs, the usual expectation is for a good rally which will serve to correct a certain portion of the decline (usually such a rally will retrace one-third to two-thirds of the preceding drop, even during primary bear markets). Occasionally, however, the market is so fundamentally weak that instead of the expected rally the Averages will move sideways, thereby gradually working off the oversold condition with a minimum of dramatic upside action.



With this background in mind, it will be well to watch the market over the period ahead. As noted, there is no question but that this market is oversold by "normal" standards. Both the advance-decline ratio and the large number of new lows suggest that downside compression has been acute. Therefore, I would say that unless this market can mount a substantial rally during the period ahead, we can expect a further period of horizontal movement — preparatory to a new downward leg, a leg which could amaze everyone with its violence and "air pockets" on the downside (I base the last thought on the very vulnerable margin situation which now exists).

SIGNALS: Referring to the odd-lot ratio on the page 1 composite chart, note that this ratio has moved to its lowest level (125) since late-1970! This means that odd-lotters have launched a major move towards the buying side. History suggests that this "change in sentiment" (even though odd-lotters normally tend to buy a decline) will be a wrong one.

The Aaa Bond/T-Bill yield ratio (see Letter 554) declined last week to 1.18. This is below the critical 1.20 level, and a strong "sell signal" is thus given. The drop in the ratio was brought on by the rise to 6.06% yield in the 91-day Treasury bills (the current 7.17% Aaa Corporate Bond yield is divided by the 6.06% Bill yield to arrive at the 1.18 index number).

GOLD & MONEY: Many centuries ago men did not have paper money. Things of value were bartered for other things of value. Even then, men appreciated and enjoyed the "look and the feel" of certain rare stones and metals, not the least of which was gold. Some of the properties men liked about gold was that it was fantastically malleable, ductile, pliable, it could be beaten into paper thinness, worked into wire or melted into forms. Furthermore, gold did not tarnish or oxidize and it retained its deep beautiful luster forever. Finally it was scarce enough so that it assumed an exotic value of its own. From the dawn of history, gold assumed a value which has never been seriously questioned.

But men found it dangerous and often burdensome to carry gold around with them. Some men (they were usually goldsmiths or metalsmiths) found it useful to issue their own "money" or certificates which told the bearer that this piece of paper was backed by a specific amount of gold held by the merchant. Thus, paper money was a "portable statement" to the effect that this was proof of ownership of a certain amount of gold. All of this is carefully explained in many books, including Elgin Groseclose's great volume, "Man and Money."

Very few people understand this fundamental concept of paper money. Real money in the essential sense is imbued with an intrinsic value of its own, and since the beginning of time money has been considered synonymous with gold. Paper has no value of its own, it is only portable proof of the owner's claim on real money (gold). Legal tender, not to be confused with real money, is anything which a government deems you can legally pay off a debt or obligation with. If the US Government passes a law stating that teak wood blocks are legal tender, you could pay your grocery bills and rent with teak wood blocks. But try to buy a Volvo in Sweden with teak blocks. Or hold those teak blocks for twenty years and see what they'll bring.

Therefore, legal tender (such as today's dollars) is usable because US law says it is usable. But if you own real money (gold), no one has to legislate anything. As a matter of fact, the US Government can claim that gold is a relic, a joke, it's going out of style, and Uncle Sam will be whistling in the wind. Gold's acceptance as an international store-of-value money has a credibility far greater than the word of the US Government.

It is estimated that there are now about $300 billion in the international private sector, most of this owned by US multinational companies and banks. Each week and each month, a portion of this ocean of dollars goes into hedging against inflation. It goes into gold, diamonds, silver, precious stones, art, etc. In this hedging process, institutions and investors are driving the price of everything higher. If all the gold ever mined were poured onto a football field, it would fill that field to a depth of only one foot. Now part of that gold, the part which is in central banks, will have to fund all the world's currencies — including dollars. In other words, the dollar, if it is to become convertible and therefore trusted, will have to be quoted against gold. And it will have to be exchanged for gold, at the option of the owner. In order for that to happen, the dollar price of gold will have to climb higher than anything envisioned today.

In an article in the March 7 Financial World, the brilliant Bill Tehan talks about a float of the world currencies, then a great rise in interest rates and a trade war as all nations seek to hold their own in a gathering depression. Next, Tehan sees a "hyper-inflation" as the Free World prints paper money relentlessly in an effort to turn the tide of economic collapse. During this great inflation he sees the price of gold going "...in the area of $500 to $1000 an ounce with a very good chance of much higher. Here it is $90 and we are barely into a world recession."

What do I think of all this? I know (as Baruch said) that two and two must equal four. I know that when you're piling up chips in a poker game, sooner or later you want to turn those chips in. The more chips you collect, the more anxious you become. Those chips must be convertible or you're being robbed. If the banker is in trouble, you'll make a deal with him and lower the "call value" of the chips. That's called devaluation. But once you suspect that the banker is in trouble, the distrust factor looms increasingly larger. Then there is only one question on your mind — conversion of those chips and at what price. That's where Europe and Japan are today.

The currencies of the Free World are being floated in the latest emergency-effort to provide the dollar with artificial respiration. But obviously Europe and Japan cannot stand by with their exports sliding while the US competitive position is kept alive with a continual float. The fateful decision is drawing closer. If Mr. Nixon accepts it now (as I think he must), then deflation, not inflation, is the spector on the horizon. Wall Street has been deflating itself for many months now. "When coming events cast their shadows before," wrote William Hamilton, "those shadows fall on the New York Stock Exchange."

OBSERVATIONS, MONDAY, MARCH 19: The dollar is now floating with no support for the first time in 29 years. One big NYC bank boosted its prime rate 1/2% to 6.75%, and this means that money rates throughout the nation will jump again. The price of gold held steady at $82 (it appears that $80 could be a new floor for gold on the downside).

On March 19 Barron's reported that NYSE accounts with customers' equity under 40% jumped to 16% of the total, highest figure on record. Thus the margin situation is becoming extremely vulnerable as this market sags and shudders downward.

The two indicators which are shown on the top of page 1 gave bearish signals with the A-D ratio dropping to a new low below the 1970 crash low on March 16. The Primary Trend Index also hit a new 1972-73 low on the same day. Thus, the market is continuing to deflate, preparatory to a world business contraction which will (in my opinion) be set off by a slump in world trade.

Few people realize that in the new "non-agreements" which included the dollar float, the US has offered almost nothing except to intervene occasionally to support the dollar and to try to think of ways of bringing home some of the $80 billion which is bouncing around the world like a crazed rubber ball. Why does Europe and Japan accept the present absurd situation? My only explanation is Russell's Third Law: "Politicians always adhere to the status quo until such times as it becomes more dangerous to defend the status quo than to take action."

QUESTION: When should I begin selling my gold shares? I have held North American and South African shares on your recommendation for a number of years, and I now have good profits. Where do you think these shares are going?
ANSWER: I have learned that it is fruitless to try to guess the extent or duration of a true "primary movement." I believe that gold and gold shares are in a primary bull market. Inflation has been with us for two generations and it is rampant now. Our Government is not confronting this danger seriously. All the while (until 1971) the price of gold has been artificially "held down." Government anti-gold propaganda has been ceaseless, loud and angry. The public has believed it. Now the price of gold and gold shares are rising in a primary bull movement. The movement is stronger than all the voices of our Government, our bankers, our Treasury, our Federal Reserve Board.

The great primary rises occur when the stock or commodity "climb a wall of worry." That describes the gold rise perfectly. The public has not accepted or understood that inflation builds increasing distrust in paper money. Eventually, the public will see what has happened to its dollars, its savings, its assets, and they will panic into the repository of value, gold. When that happens, the "real" gold rise will be on. At that time I will suggest that we start scaling out all our gold shares. Such a period could be characterized by great chaos, a frightening international crisis, a crisis which upsets the heads of government, not just those who are seeking to hedge their paper money with purchases of gold (as now).

QUESTION: Why do our Administration leaders keep blaming international speculators for the monetary troubles? Why do they keep blaming Europe and "mal-adjustments in monetary parities" for the trouble? Why don't they deal with the fundamentals?
ANSWER: Behind every lie and self-deception lies the avoidance of pain. Suppose the President were to go on national TV and say this to the American people, "My friends, we are not competing successfully in international markets. We have squandered our wealth, our assets, our talents. All this must change, and with this our very values must change. The day of the 300 horse power car is over, the day of the family with two cars, a summer house on the beach, a swimming pool, a big credit line, three color TV sets, three-dollar movies are over. The day of the $80 billion defense budget is finished, the day of the giant welfare plan is kaput. The age of waste is done.

"My friends, we are going to move to a new era. We are going to switch from 'things' to 'people' and from waste to frugality. Starting next week, I am requesting that all employees and employers take a 25% cut in salaries. If you can't meet your expenses with this new system then get rid of your expenses. This nation is going to learn to compete in the world; we are going to turn out the best products, the most ingenius exports, the finest worksmanship anywhere. We are going to be the wonder of the earth; the new American economic miracle is about to begin. Citizens of America, prepare to do battle, our nation is about to rise from the ashes of inflation and waste — we are going to fire the imagination of the world."

Do you know what would happen? If the President even hinted at 10% of what I have written above, he would be impeached or institutionalized. What this nation and its leaders are seeking is a painless way to extricate itself from its current situation. Our leaders don't understand that after a drunken orgy, there comes the painful sobering. I never knew a man who stayed drunk forever.

THOUGHTS: I know that some subscribers must think, "Russell has alot of blasted gall jamming his personal philosophy into a stock market report that I pay my good money for." In my defense, all I can say is that when you buy anything that helps you, it's an investment. What irritates one man may interest another. Indulge me, my readers.

Once in a while I toss Barron's or Business Week to the foot of my bed and pick up the Bible. I tend to gravitate towards the Gospels. In reading Luke last night I was struck by the following: A blind man was squatting in the dust as Jesus walked by. The man shouted, "Jesus, Son of David, have pity on me." Jesus' irritated followers shouted at the blind man to be quiet, but... "Jesus stopped and ordered them to bring the man to him, and when he came up, asked him, 'What do you want me to do for you?' 'Sir,' the blind man replied, 'Let me see again.' Jesus said to him, 'Receive your sight. Your faith has saved you.' And instantly his sight returned and he followed him and praised God, and all the people who saw it gave praise to God for what had happened."

When I read this I was startled. Wow, I said to myself, what kind of fantastic faith and intuition make a blind man, a man who has never even seen the man he is addressing, shout, "Let me see again." Not the slightest doubt in that request, not the vaguest fear that the miracle will fail to materialize if Jesus decides to act.

Somehow I immediately translated that whole, incredible scene to the present. I look out my window and see the weary, tired, mask-like faces walk past the window. People living on fears, "shoulds," appearances, rituals, and acting the way they "think" society wants them to act. People cutting off the life forces within them, stifling their intuition, killing their real feelings. If the blind man in the Bible had acted the same way, he would have lived out his days with dead eyes.

I have come to believe that the highest force within us is our "inner voice," the thing which some call intuition. That voice tells us what's really going on, it cuts through the deadness and the fog. I believe that our inner voices connect us all in a sort of universal unconscious. But one has to learn to listen to one's inner voice, then act on it.

Listening to the inner voice is one of the secrets of life (the blind man knew this). What the inner voice is "saying" very often feels outrageous or impossible. Yet I know at least five instances where listening to my own inner voice has actually saved my life.

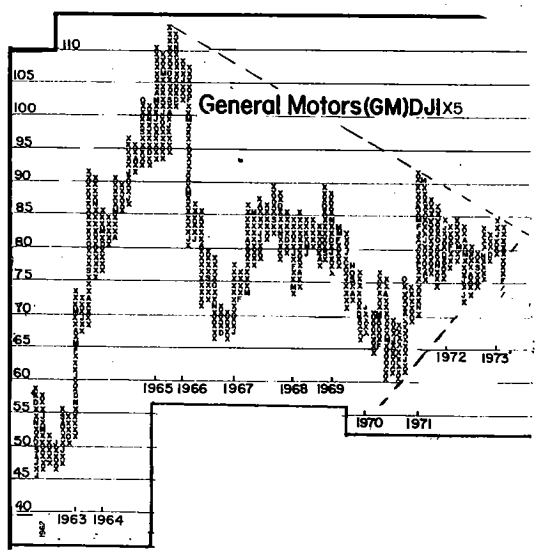
In a less dramatic context, I was at a party a week ago, and after an hour passed I realized that the party had settled down to utter boredom, safeness, nothingness. I had my choice of leaving or coming to life myself. My inner voice shouted, "Speak up." I did. I said, "Hey, I don't know about anyone else, but I came here to know people, not to play it safe with alot of tea party, polite conversation about the price of eggs or the new housing statistics for Southern California. I'm bored and I'm part of the boredom. The only real thing that's happened to me since I've been here tonight is to experience the fact that I'm bored."

There was a tense, utter silence for about a minute, and it was evident that everyone was struggling with their own fear. But there was also an excitement in the air. Then one man said, "You know, I agree with you!" Within ten minutes, the party became fascinating, and it stayed that way until the end.

Later I realized clearly that my inner voice had said, "Speak up, things can't get any worse." My sense of propriety said, "Keep quiet, you'll make a fool of yourself and they'll hate you for it besides." My inner voice proved to be right. I firmly believe that a man's inner voice is his connection with the universal power. My own inner voice has never steered me wrong. More and more I try to "connect" with my inner voice. If you're religious, you may experience that God speaks to you through your inner voice. If you are not religious, you may at least realize that there is some great power in your intuition, and that to "live intuitively" is to live in an exciting, "different" way. Intuitive living is the path away from deadness — towards life.

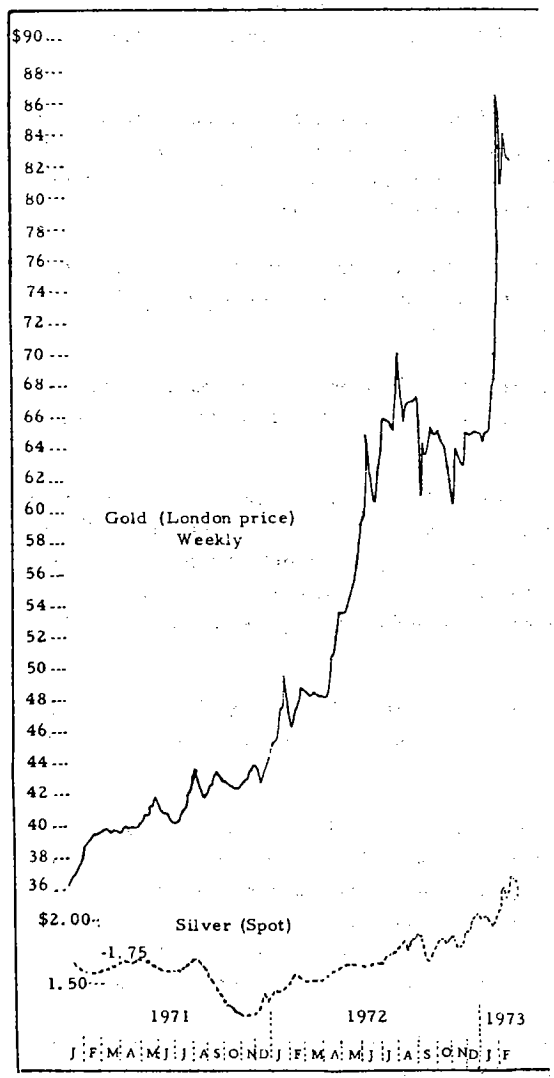
Your intuition presents itself in many ways and you feel "right" when you follow it. Last week I was fascinated as I read an interview with Jack Lemmon, the well-known actor. His father was a baker, and when Lemmon told him that he wanted to be an actor his father asked, "Do you really need to do this?" Lemmon said, "Yes, I need to do it." His father then said, "Then you love it. The day I don't find romance in a loaf of bread, I'll quit." The baker was explaining to the actor the importance of intuitive living.

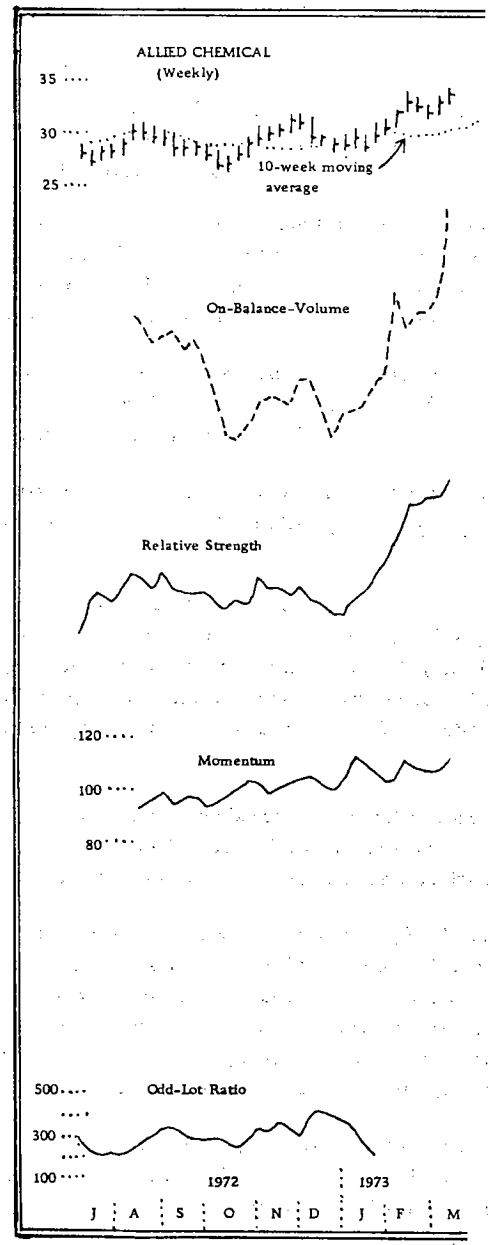
STOCKS: On March 19 General Motors, the bellwether stock for the market, broke to 72 1/8, and in so doing sank to a new low for the year. I consider GM's breaking to a new low in the first quarter of the year to be a very bearish sign. This largest of all manufacturing companies takes up such a chunk of the GNP that it makes me wonder what is in store for the economy. Particularly since the new low came in the face of record auto sales and booming profits.



I include a point & figure chart of GM, courtesy of Crosschart, 18 E. 41 St., NYC 10017. I have drawn in the dashed trendlines, and it is clear that GM's stock is facing a "moment of truth." GM is down from 1965's record high of 113 3/4, which means that GM has suffered a 37% loss in market value or roughly 5% a year over the past eight years.

But if GM touches 71 it will set off a P & F sell signal (note that it has already broken the ascending trendline) At 71, GM will be in line to test the 1970 low of 59 1/2 (which shows up as 60 on a P & F chart. Therefore, watch 71 on GM as an important "general market signal."





In a run-down on the 30 Dow Industrial stocks, this week produced the weakest showing since I began these studies. Only one stock was on the strong list (a rating of 4 or better), and that stock was Allied Chemical. Only one stock produced a 3 and that was Anaconda, which is holding valiantly above 22 (and seems to want to go higher, given any kind of a market). There were twenty Dow Industrials on the weak rating list, which consists of a rating of either zero or one, and this is the largest number of weak Dow stocks I have seen in the past nine months.

I am again reproducing my chart of Allied, since I feel that this star deserves special mention (it actually hit a new high last week). On-balance-volume on ACD has been excellent, rising to new highs. Relative strength has also been superb, and momentum (the stock's ratio against its own price of 13 weeks ago) is trending upwards. Unfortunately, the SEC has not released figures for odd-lots on individual stocks for the past three weeks, so we will have to await updating on this bottom index.

For those who cannot resist speculating on every rally, my studies show that Allied Chemical and Anaconda are the current heroes.

GOLD & SILVER: The gold chart shows another consolidation period with the base price or support at $80. I doubt whether this consolidation is going to last as long as the 1972 affair, which fixed the gold floor at $60, tested that level many times, then catapaulted gold over $80.

Silver is now quoted at a spot price of $2.20. It should be remembered that silver is not a monetary metal and no central bank in the world hoards the white metal. The strongest things going for silver are (1) increased consumption against sharply depleted supplies, (2) the historical silver-gold price ratio which now favors a rise in silver since it is far too cheap in relation to gold.